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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1942

No. 305

E. J. THOMAS, J. R. MCDONALD, J. R. MASON, E. G. WLLIAMS and A. C. CARPY,

Petitioners,

vs.

EL DORADO IRRIGATION DISTRICT,

Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit
and
BRIEF IN SUPPORT THEREOF.

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Petitioners,

vs.

EL DORADO IRRIGATION DISTRICT,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals for the Ninth Circuit.

To the Honorable Harlan Fiske Stone, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

Petitioners pray that a writ of certiorari issue to review the decision (R. 306) of the Circuit Court of Appeals for the Ninth Circuit made in the above entitled cause on March 30, 1942, rehearing denied with

amendment to opinion May 29, 1942, which affirmed the interlocutory decree of the District Court of the Northern District of California, Northern Division, rendered against petitioners on March 8, 1941. (R. 255, 263.)

OPINION BELOW.

Opinion of the Circuit Court of Appeals, 126 Fed. (2d) 922, ... Fed. (2d) ..... (R. 292, 307.)

JURISDICTION.

The decision in the Circuit Court of Appeals was rendered March 30, 1942, and rehearing denied with amendment to the opinion May 29, 1942. (R. 306, 307.) The mandate was stayed until disposition of the case by this Court. (R. 308.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code (28 U. S. C., paragraph 347 (a)).

STATUTES INVOLVED.

Municipal Bankruptcy Act of May 24, 1934, c. 345, (48 Stat. 798), 11 U. S. C. 301-303, adding Sections 78-80 to the Bankruptcy Act of 1898; Act of August 16, 1937, c. 657 (50 Stat. 654), 11 U. S. C. 401-404, adding Sections 81-84; and Act of June 22, 1938, c. 575, Sec. 3 (b) (52 Stat. 940). Principal California Statute involved is "the California Irrigation District Act", Cal. Stat. 1897, p. 254, as amended.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

This is a proceeding brought by the respondent El Dorado Irrigation District, a California irrigation district, for confirmation of composition of debts under Chapter IX of the Bankruptcy Act of 1898 as amended. (11 U. S. C. Sec. 401-404.)

The matter came on before the District Court for hearing February 27, 1940 (R. 49), on the petition filed by the El Dorado Irrigation District, hereinafter called the district, filed October 7, 1938 (R. 2, 23) and the answer and objections to the petition filed by the petitioners herein who are creditors of the district. (R. 23.)

The district is an agency of the state organized under Cal. Stats. 1897, p. 254 as amended (R. 2), popularly known as "the California Irrigation District Act". The district comprises 30,702 acres of land situate in El Dorado County, California. (R. 2.) The office of the district is located in the City of Placerville, in that county. (R. 2.)

The district had issued $688,000 principal amount of interest bearing public bonds dated March 1, 1927 (R. 14) in denominations of $1000 bearing 6% interest, payable semi-annually and represented by interest coupons (R. 3) and which mature from January 1, 1948 to January 1, 1967 (R. 12), none of said bonds maturing until 10 years after the date of the filing of the petition. The district also had outstanding $24,437.77 in warrants. (R. 14.)

The district applied to the Reconstruction Finance Corporation (herein referred to as the R. F. C.), for

a loan of $360,500 to refinance this debt (R. 14) on the basis of 50.5% of the principal and 33-⅓% of a portion of the interest. (R. 19.) The loan was granted September 26, 1934 (R. 67) and the district proposed to issue 4% refunding bonds for the amount of the loan to be delivered to the R. F. C. (R. 19.)

After obtaining the loan from the R. F. C. to enable the district to undertake its refunding operation, 95% of the bonds were deposited in escrow in 1935 (R. 67) for delivery to the treasurer of the district upon payment of $505 per $1000 bonds, plus a small amount of interest.

This district on February 9, 1935 filed a bankruptcy petition under the first municipal bankruptcy act in which proceeding a judgment of dismissal (R. 130) was entered after that act was held unconstitutional. In that proceeding, the Court had made an order (R. 64, 67) authorizing the R. F. C. to purchase 634 bonds of the 688 bonds of the district and the warrants then deposited in escrow.

Based on the title thus acquired the R. F. C. filed a consent to this second bankruptcy proceeding (R. 19) reciting that it had purchased $664,000 of bonds and $24,437.77 of warrants of the district, this being 96% of the bonds and warrants of the district.

These dates and recitals are important because the first point which the petitioners seek to have reviewed in this Court is the point that the district subsequent to 1935 paid off one of the warrant creditors at the rate of 82½% of its claim, thereby, petitioners contend, creating an unlawful preference and tainting the

composition with bad faith. (This was 82½% of both principal and interest, the interest amounted to more than half as much as principal.)

Both bonds and warrants are of the same character. Section 39 of the California Irrigation District Act, Stats. Cal. 1931, page 122, provides for one levy to be made annually against the value of the land of the district for both the warrants and bond indebtedness. Both are payable from the same source and therefore are in the same class. Title 11 U. S. C. Sec. 403 (b).

The loan obtained from the R. F. C. was slated to pay roughly 50.5% of principal of bonds and of warrants. (R. 14, 15.) After obtaining this loan from the R. F. C. the district filed its first bankruptcy petition February 9, 1935. (R. 129.) A judgment was entered dismissing the bankruptcy petition. (R. 130.) Thereafter the district made an offer of compromise which was accepted by the California National Bank, receiver holding $16,286.33 including interest of warrant indebtedness. (R. 155, 132.) It is contended by petitioners that the plan of composition was thereby abandoned and could not thereafter be approved on the basis of 50.5 cents. *Roberts v. Board of Public Instruction,* 117 Fed. (2d) 943; *U. S. v. Greer Dr. Dist.,* 121 Fed. (2d) 675; *Clarke v. White,* 12 Pet. 178, 9 U. S. (L. Ed.) 1046; *Zavelo v. Reeves,* 227 U. S. 625; *Texas Hotel Corp. v. Waco Dev. Co.,* 87 Fed. (2d) 395, 399; *John Hancock Mutual Life Insurance Co. v. Bartels,* 308 U. S. 180, 60 S. Ct. 221; *American United Mutual Life Ins. Co. v. City of Avon Park,* 311 U. S. 138, 61 S. Ct. 157.

It is perfectly obvious that the change in the plan of composition omitting reference to the warrant indebtedness is a bold subterfuge to avoid the charge of bad faith made by petitioners. This is obvious from the R. F. C.'s "acceptance" of the plan of warrant liquidation as well as the bond plan. (R. 19.) The board of directors of the district in its resolution adopt a plan for composition of the entire bond and warrant debt. (R. 14.) The Court had authorized the purchase of warrants as well as bonds. (R. 65, 67.) The plan of composition therefore still undeniably includes the warrants.

Findings and decree were entered in this case March 8, 1941. (R. 241, 243.) Prior thereto Congress passed Section 3, Public 669, 76th Congress, approved June 28, 1940, as follows:

> "Before concluding the hearing, the judge shall carefully examine all of the contracts, proposals, acceptances, deposit agreements, and all other papers relating to the plan, specifically for the purpose of ascertaining if the fiscal agent, attorney, or other person, firm, or corporation promoting the composition, or doing anything of such nature, has been or is to be compensated, directly or indirectly, by both the petitioner and the creditors thereof, or any of such creditors—either by fee, commission, or other similar payment, or by transfer or exchange of bonds or other evidence of indebtedness whereby a profit could accrue—and shall take evidence under oath to make certain whether or not any such practice obtains or might obtain.
>
> "After such examination the judge shall make an adjudication of this issue, as a separate part

of his interlocutory decree, and if it be found that any such practice be possible, he shall forthwith dismiss the proceeding and tax all of the costs against such fiscal agent, attorney, or other person, firm, or corporation promoting the composition, or doing anything of such a nature, or against the petitioner, unless such plan be modified within the time to be allowed by the judge so as to eliminate the possibility of any such practice, in which event the judge may proceed to further consideration of the confirmation of the plan."

There is no evidence in the record on this matter. There was no examination on oath or otherwise by the Court to determine whether or not the practice frowned upon by Congress had obtained or could obtain. The burden of proof is on the district. *In re Cook,* 104 Fed. (2d) 981.

The third point which petitioners make is that the plan of composition is unfair and that there is no evidence in the record to sustain the legal conclusion that the district can pay no more than 50.5 cents. None of the bonds will mature until 1948. Food prices, labor, clothing and all materials, have advanced sharply. Rents and land values have risen. The most that the taxpayers in this district should have sought was an adjustment of interest. Most of the material facts in the record are stipulated. It was stipulated that the assessed value of the bare lands of the district approximated $2,000,000. (R. 98.) The average uncollected taxes for nine years was only 7.4% (R. 98) whereas tax levies are made for 15% more than the budget under Section 60 of "the California Irrigation

District Act", Cal. Stat. 1919 page 669. The County of El Dorado assesses the value of the land in the district at $921,000 (R. 134), and the improvements on these lands at $913,000. Yet a plan paying $360,500 is approved. And all of this is exclusive of the real property in the City of Placerville, which is also within the irrigation district and subject to unlimited *ad valorem* taxation by the district. The county in which this city is situated assesses the land within the city at $296,350 and the improvements at $787,280, yet no account is taken of the taxpaying ability of the property within the city. All land sold at tax sale to the district has been resold and placed back on the tax roll (R. 223) proving that the value of the security for the whole debt is ample to pay the debt in full. Testimony from rural inhabitants operating only about 600 acres out of at least 30,000 acres was relied upon for proof of the fairness of the drastic scaling down of tax secured indebtedness herein demanded. The aggregate city and county assessed value of all lands, improvements inside of the district is the sum of $2,917,730 and it was stipulated that this was not over 50% of the actual value, so that the real value of this property subject to tax would equal $6,000,000. (R. 134.) This is almost 1000% of the old indebtedness, and almost 2000% of the composition offer, of $360,500.

The County of El Dorado, Placerville Grammar School District, the El Dorado High School district overlap this area, and none of the bonds of these districts have been worth on the market less than par (R. 135) nor have any of these issues been in default since 1928. (R. 135.)

The capital assets of the district including office buildings, water rights, reservoirs and pipe lines are the fair value of approximately $600,000. (R. 136.)

The Court failed to take into consideration or even to require evidence of the duty and ability of the real property in the City of Placerville to pay irrigation district taxes. All the land of this substantial city is forever liable to the last city lot to pay taxes for the bonds sought to be scaled down. Yet the city is substantially ignored as a taxpaying factor. The revenue collecting ability of the district was not gone into except as to farmers holding about 600 acres of pear orchards.

The City of Placerville is included in the boundaries of the district and comprises 1160 acres. (R. 219.) It is the famous "Hangtown" of California gold rush days only it is not an abandoned city but a thriving and important mountain city with a population of 2320 as the census will show. It is a county seat and even in the days of horse drawn vehicles registered over 3000 tolls per day over its transcontinental carriage route.

No testimony whatever was introduced as to the wealth of this little city nor of its tax paying ability.

The witnesses who testified told mainly of ups and downs of the Bartlett Pear industry, utilizing but 20% of the acreage of the district and which is the most important crop in the district. (R. 227, 155, 61, 62.)

But not only the pear growers on 600 acres are obligated to pay taxes. (R. 176.)

The studies made related to these 600 acres only and consequently the "ability to pay" was not the ability to pay of the taxpayers holding 30,000 acres, nor land in the City of Placerville, but of 600 acres only.

QUESTIONS PRESENTED.

1. Where a municipal bankruptcy plan of composition was accepted prior to 1936 by over 90% of the bondholders who surrendered their bonds and accepted 50½ cents on the dollar of principal in full settlement of their claims and thereafter the public debtor, and prior to the enactment of the amended municipal bankruptcy law and (after the original municipal bankruptcy law had been declared unconstitutional) pays one of its important creditors at 82½% of principal and 82½% of interest and after the amended municipal bankruptcy law was enacted files its petition again for composition of its debts and seeks a judgment requiring its remaining original creditors to accept 50.5% of principal alone, does the payment of 82½% to its one creditor constitute an unlawful preference and bad faith so as to invalidate the plan of composition, as petitioners contend?

2. Does Section 96, 11 U. S. C. apply to a municipal bankruptcy case wherein a preference is shown in favor of one of the creditors?

3. Is an interlocutory decree valid which was entered after the enactment of c. 438, Secs. 2, 3, 54 Stat. 668, 669, requiring the Court to investigate the

circumstances surrounding the deposit of the securities and whether the fiscal agents of the district were or were not improperly compensated, where the Court made no such investigation?

4. Where the bonds of a public debtor are secured by the unlimited ad valorem power of taxation upon all the lands within its boundaries whether agricultural, industrial, mining or urban, and where evidence introduced to show the fairness of the plan of composition concerned only the ability of a certain small section of the agricultural area and did not include an examination of the ability of 5/6 of the lands, nor of the area of an important city within that area to pay taxes, and the property in that city is equally and irrevocably subject to taxation to pay the last dollar of irrigation district indebtedness, is the plan of composition not unfair as a matter of law?

5. Where the findings and decree contain only conclusions of law as to the fairness of the plan of composition, should the case not have been remanded for special findings on the facts?

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT.

1. We submit that this Court should decide each of the "Questions presented" set out above.

In *American United Mutual Life Insurance Company v. City of Avon Park,* 311 U. S. 138, this Court for the first time considered the procedure under the municipal bankruptcy act, and declared:

> "Beyond that is the question of unfair discrimination to which we have adverted. Compositions under Ch. IX, like compositions under the old Sec. 12, 11 U. S. C. A. Sec. 30, envisage equality of treatment of creditors. Under that section and its antecedents, a composition would not be confirmed where one creditor was obtaining some special favor or inducement not accorded the others, whether that consideration moved from the debtor or from another. In re Sawyer, Fed. Cas. No. 12395; In re Weintrob, D. C. 240 F. 532; In re M. & H. Gordon, D. C. 245 F. 905."

We submit it is an essential feature of all composition proceedings that creditors should receive equality of treatment. Where all other creditors received 50.5 cents of principal and one creditor received 82.5 cents of principal and interest, there is not equality of treatment and this Court ought to determine, we submit, whether the principle of equality of treatment applies to municipal bankruptcy cases.

2. The Court below has decided another important question of law incorrectly, we submit, which is whether where one creditor has been preferred by receiving a bonus payment to induce him to accept the plan of composition, the statutory rule as to preferences set forth in Tit. 11 U. S. C. Sec. 96 cures the preference. The lower Court has so held. We submit the conclusion is erroneous and establishes a principle which should not be followed or sanctioned in municipal bankruptcy cases. We submit Sec. 96 does not apply to a composition case under Chap. IX of the Bankruptcy Act.

3. The trial Court has completely ignored the specific direction of the bankruptcy statute contained in the amendment of June 28, 1940. (c. 438, Secs. 2, 3, 54, Stats. 668, 669.) By this section the Congress directed that the judge before concluding the hearing should make an examination "specifically for the purpose of ascertaining if the fiscal agent, attorney or other person, firm or corporation promoting the composition—has been or is to be compensated, directly or indirectly, by both the petitioner and the creditors thereof", and that the judge should make an adjudication of this issue as a separate part of his decree. This mandatory instruction was not followed, either in the examination directed or in the interlocutory decree. We submit this Court ought to declare that such direction in the statute is mandatory.

4. We submit that as a matter of law where the examination in the trial Court pertained only to one-sixth of the lands within the public debtor, which lands are the security for the bonds sought to be scaled down, and there is an important city in the district, and no consideration is given to the taxpaying ability of the area within the city or in five-sixths of the land not intensively cultivated, the plan of composition is not shown to be fair as a matter of law, and this Court ought to determine that all important sources of taxpaying ability should be considered by the Court.

5. Where the findings and decree contain only conclusions of law as to the fairness of the plan of composition, the case should have been remanded for further findings. There is a conflict in the decision of

the very lower Court from which this proceeding stems, the conflict being between the decision in this case and in the case of *Lorber v. Vista Irr. Dist.*, 127 Fed. (2d) 628. This Court should, we submit, determine the question involved.

Wherefore, petitioners pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding that Court to certify and send to this Court for its review and determination a full and complete transcript of the record and of the proceedings of said Court in the case numbered and entitled in its dockets as "No. 9851, E. J. Thomas, J. R. McDonald, J. R. Mason, E. G. Williams and A. C. Carpy, Creditors of the El Dorado Irrigation District, Appellants, v. El Dorado Irrigation District, Appellee", and that the decree of said Court be reversed by this Court with directions to dismiss the bill, and for such other relief as to this Court may seem proper.

Dated, Turlock, California,
August 12, 1942.

E. J. THOMAS,
J. R. MCDONALD,
J. R. MASON,
E. G. WILLIAMS,
A. C. CARPY,
Petitioners.

W. COBURN COOK,
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